Small Managers, Big Alpha

Stockholm (HedgeNordic) – Not too often in the world of finance are things painted only in black and white. On some topics though, it seems, academic studies and practitioner literature can largely agree. One of these rare theories, at large, suggests that smaller managers tend to outperform their larger peers. Past research also finds that investment performance deteriorates as fund size increases. HedgeNordic asked several young, emerging managers in the Nordics whether a relatively smaller size represents an advantage and at what point size starts affecting performance?

"Most, if not all, portfolio managers who have managed both a large and a small fund would agree that it is more optimal for returns to operate a smaller fund," considers Christer Bjørndal, Co-Founder of Norwegian asset manager CARN Capital. "You can also see it in data on fund performance, which shows a negative scale effect on returns when funds get too large. Typically, the larger the fund, the poorer returns," he continues. Nimbleness, as reflected by the ability to move in and out of positions, can enable smaller managers to capture opportunities that larger managers cannot.

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The Sweet Spot


Christer Bjørndal, Co-Founder at CARN Capital.

"Liquidity and sizing get harder to manage the larger the fund gets," argues Bjørndal, who oversees a firm running a long-only and a long/short equity fund. The long/short vehicle – CARN Latitude – ranked second in the "Best Nordic Equity Hedge Fund" category at the 2020 Nordic Hedge Award. "It is often the case that the most attractive investments are not available to larger funds due to size," Bjørndal tells HedgeNordic. "This can be offset to some extent by hiring more people, becoming a better investor, optimizing processes, among other things, but it will inevitably reach a point where size hurts performance," he emphasizes. "It is almost a fundamental law within asset management. We believe it is important to limit the size of the fund, ideally at the point where these two factors are optimized and not hurting performance.”


Alexander Hyll, Founder and Portfolio Manager at Adaptive Paradigm Alpha.

“The size of the market niche you operate in and liquidity constraints are important when determining how large you can become,” explains Bjørndal. Bjørndal’s views are backed by other Nordic managers. “We believe there is a goldilocks AUM for any given strategy where you have both the best available tools and talent, and where capacity issues have not yet had too large diminishing returns on alpha,” says Alexander Hyll, the founder of Linköping-based long/short equity fund Adaptive Paradigm Alpha. “Finding and maintaining this size can therefore be a key advantage in offering the best possible asset management for clients,” he emphasizes. “During times of extreme events, our relatively smaller size has let us make risk management decisions and also execute on them without issues of localizing liquidity.”

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Accountant-turned-fund manager Andreas Aaen, who manages his long/short equity fund Symmetry Invest out of the region of Aalborg in Denmark, agrees, saying that “it is all about finding the sweet spot.” Symmetry Invest has grown from DKK 100 million to DKK 400 million over the last two years, giving Aaen the flexibility to steer his money management business in the right direction. “We have used this to lower the fixed management fee, invest in more people and a lot of data and subscriptions,” says Aaen. “If the manager reinvests the additional fees into building a better business, then size is an advantage at least until position sizing becomes a problem.”

Andreas Aaen, Founder and Portfolio Manager at Symmetry Invest.

"A small size is an advantage, but being too small is a disadvantage," argues Aaen, who founded Symmetry Invest in early 2013 to manage his own money and capital from friends and family. "Just looking at the journey since inception, Symmetry Invest's returns compounded at around 20 percent a year for the first five years when the fund managed from DKK 5 to 100 million in assets," Aaen tells HedgeNordic. "But over the last three years, we have compounded at 40 percent per year with DKK 200-400 million in assets due to us reinvesting in the business and using size to our advantage."

The Tipping Point

Smaller managers have the flexibility to invest in excellent risk-reward opportunities that would not have a significant impact on a larger manager's portfolio. Warren Buffett himself pointed out that smaller investors can play their advantage to outperform larger investors. At some point, therefore, size does become a problem. "Liquidity is limited and slippage can become large, which leads to a limit for how much capital can be allocated to a given opportunity," argues Hyll. "Markets also have a finite amount of alpha that can be extracted," he explains. "At any given time, there may be a set of more appealing opportunities for a strategy, so an exceptional size can limit cherry-picking of opportunities, therefore diminishing returns."

"We see both in academia and practice that size hurts performance," points out Bjørndal. "The larger one becomes, the harder it is to maneuver effectively. At a certain point, it will start to hurt performance," he emphasizes. Aaen, who co-manages Symmetry Invest with Henrik Abrahamson, agrees that "at some point, size can and will become an obstacle if you are not able to grow your capabilities along." On the question of how much is too much, the three money managers seem to suggest the same well-fitting answer: "it depends." For Adaptive Hedge Fund Management, CARN Capital, and Symmetry Invest, size has yet to become a problem.

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Forget Size, Focus on What You Do Best

Smaller and emerging managers can continue to reap great rewards over time for their investors by focusing on what they are good at. “The most important part is to constantly improve but always stay true to the foundation,” emphasizes Andreas Aaen. “If the business was founded on a concentrated small-cap strategy, you cannot suddenly become a diversified large-cap fund because you end up with too much assets under management,” he continues. “But staying true with the strategy, you can use size to become better and better at what you do.”

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The team at CARN Capital has been keen on staying true to its original approach and focus on the smaller-cap universe. “We see it as an advantage to be smaller as it opens the investment universe for a more attractive space to operate in. For us, that is within the small- and mid-cap segment,” Bjørndal tells HedgeNordic. “In practice, it increases the investment universe to a niche where we see higher potential for adding alpha over time,” he elaborates. “Our limited size is in this respect a comparative advantage for us. To be able to invest in smaller companies has been, and will continue to be, an important source of return for CARN.”

This article featured in HedgeNordic’s “Finding Alpha in Equities” publication.